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***Memorandum*** June 28, 2000

TO : House Government Reform Committee
Attention: Mildred Webber

House Science Committee
Attention: Richard Russell

FROM : Morton Rosenberg
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SUBJECT : Environmental Protection Agency Options for Ameliorating the Effects Of Reformulated Gas Requirements in the Chicago/Milwaukee Area

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The Clean Air Act amendments of 1990[1] required areas with poor air quality to add chemicals called "oxygenates" to gasoline as a means of improving combustion and, thereby, reducing emissions.[2] Section 211 (k) of the Act[3] and the regulations promulgated thereunder[4] prohibit the sale of conventional gasoline in an area in which reformulated gasoline (RFG) is required. Violators of the regulatory requirements may be assessed a civil penalty of up to $25,000 for each day of such violation as well the amount of economic benefit or savings resulting from the violation.[5]

Recent steep rises in the retail price of gasoline in midwestern RFG areas have resulted in calls by federal, state and local elected officials and gasoline marketers for ameliorative action by the Environmental Protection Agency (EPA) and for the institution of Federal Trade Commission and congressional committee investigations as to whether the increased prices are due to environmental rules, high prices for crude oil, supply disruptions or collusion, or some combination of these factors. Your particular interest at the moment is the nature of any possible actions the EPA may take to temporarily

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[1] Pub. L. 101-589.
[2] See generally, CRS Issue Brief IB 10004, *Clean Air Act Issues in the 106th Congress*, at pp. 4-6 (CRS Issue Brief).
[3] *Codified at* 42 U.S.C. 7545 (k) (1994).
[4] 40 CFR Part 80, Subpart D.
[5] 40 CFR 80.79, 80.80.

mitigate the impact on consumers of the price rises in the Chicago/Milwaukee area.

Our review of EPA's authority and recent practice in this area indicates that at least three courses of ameliorative action may be available to the agency, each of which may be subject to issues of practical utility or possible questions of authority, or both. These options are a waiver under Section 211 (k) (2) (B) of the Act; a waiver under 40 CFR 80.73; or an exercise of prosecutorial discretion not to take enforcement action regardless of Section 80.73's applicability for the period required for prices to be stabilized.

Some background on agency use of waivers and judicial approbation of their utilization is useful in assessing the scope and limitations of EPA authority in the area. Judicial precedent has long been strongly supportive of waiver and variance authority of rulemaking agencies as a means of assuring regulated parties of due process.[6] The courts have recognized that rules, by definition, tend to cover a broad range of people and activities and often affect many divergent interests. At times individual and specific activities are regulated by accident or because it was impossible to sort them out, or regulations have unanticipated untoward effects. In such circumstances courts have found that agency waivers and variances provide a legitimate mechanism for pursuing both fairness and the public interest in particular, individualized cases.[7] As a panel of the District of Columbia Circuit Court of Appeals observed, "waiver processes are a permissible device for fine tuning regulations, particularly where, as here, the Commission must enact policies based on `informed prediction' .... So long as the underlying rules are rational, as we find them to be here, waiver is an appropriate method of curtailing the inevitable excesses of the agency's general rule."[8]

As a consequence, it has been accepted that rulemaking agencies should provide a reasonable opportunity to petition for individual treatment in the form of waiver, exemption or variance. The source for such a requirement traces back to remarks in Supreme Court rulings in *United States v. Storer Broadcasting Co.*,[9] and *National*

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[6] See, *e.g.*, *Chemical Manufacturer Association* v. *Natural Resources Defense Council, Inc.*, 470 U.S. 116, 132-133 and ft. 25 (1985)(" [T]he availability of [EPA's] FDF variances makes bearable the enormous burden faced by EPA in promulgating categories of sources and setting effluent limitations. . . Unfortunately, EPA will not be appraised of and will fail to consider unique factors applicable to atypical plants during the categorical rulemaking process, and it is thus important that EPA's nationally binding categorical pretreatment standards. . . be tempered with the flexibility that the FPF variance mechanism offers, a mechanism repugnant to neither the goals nor the operation of the Act.")

[7] *American Trucking Associations, Inc. v. Federal Highway Administration*, 51 F.3d 405, 414 (4th Cir. 1995).

[8] *National Rural Telecom Association v. FCC*, 988 F.2d 174, 181 (D.C. Cir. 1993).

[9] 351 U.S. 192 (1956).

[10] 319 U.S. 190 (1943).

*Broadcasting Co. v. United States.*[10] Both of those cases appear to uphold the FCC's rulemaking efforts partly because the agency built into its regulatory scheme the flexibility necessary to offer individual treatment to those covered by the rule.[11] Neither case expressly required provision for waiver or variance, but the existence of such opportunity made the Court more comfortable with the rule. *Storer Broadcasting* in particular has been read over the years to support a right to petition for waiver or variance.[12]

The viability of waiver or variance to do individual justice was recognized by the Court in *Chemical Mfrs. Ass'n v. Natural Resources Defense Council, Inc.*[13] The Court noted that EPA had long used a variance process "as a mechanism for ensuring that its necessarily rough-hewn categories do not unfairly burden atypical plants." [14] In the 1977 amendment to the Clean Water Act, however, Congress prohibited the EPA from modifying requirements as to specific toxic pollutants. The NRDC challenged the EPA's continuation of the practice of occasionally granting variances. For several reasons, the Court found sufficient flexibility in both the language and the history of the Act to permit the variances. Since the agency wrote the standards, it appeared reasonable to the Court to assume that it had the inherent power to provide for variance.[15] Nor, the Court found, did the variance process frustrate the legislative intent or work a result inconsistent with the Act's goals.[16] Not compelled then by the Act, its history, or surrounding considerations to strike down the variance procedure, the Court considered the advisability of the variance process in this context. The Court found nothing to forbid "sensible variance mechanisms for tailoring the categories it promulgates."[17]

While most cases involve statutory or regulatory waiver provisions, a number involve the exercise of waiver authority in the absence of such authority,[18] confirming the indication of the Court in *Chemical Mfrs. Association* that rulemaking agencies have inherent authority to provide appropriate waivers.[19]

Also, the courts have made challenging the denial of a waiver a "difficult task."[20]

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[10] 319 U.S. 190 (1943).
[11] 315 U.S. at 204-05; 319 U.S. at 225.
[12] *E.g., FPC v. Texaco, Inc.*, 377 U.S. 33, 40-41 (1964); *National Petroleum Refiners Assoc.v. FTC*, 482 F.2d 672, 692 (D.C. Cir. 1973, *cert. denied*, 415 U.S. 951 (1974).
[13] 470 U.S. 116 (1985).
[14] 470 U.S. at 120.
[15] 470 U.S. at 125-130.
[16] 470 U.S. at 129.
[17] 470 U.S. at 134.
[18] See, *e.g.*, *NTN Bearing Corp.* v. *United States*, 74 F.3d 1204, 1207 (Fed. Cir. 1995); *MacLeod v. ICC*, 54 F.3d 888, 891 (D.C. Cir. 1995); *National Petroleum Refiners Assoc. v. FTC*, 482 F.2d 672, 692 (D.C. Cir. 1973).
[19] See also, *National Rural Telecom Association* v. *FCC*, 988 F. 2d 174, 181 (D.C. Cir. 1993) (" As this Court has held, waiver processes are a permissible device for fine tuning regulations, particularly where, as here, the Commission must enact policies based on 'informed prediction.' [citation omitted] So long as the rules are rational, as we find them to be here, waiver is an appropriate method of curtailing the excesses of the agency's general rule.").
[20] *MacLoed v. ICC*, 54 F.3d 888, 891 (D.C. Cir 1985).

A challenger must show that the reasons for denial were so insubstantial as to constitute an abuse of discretion.[21] Although a request for a waiver that is "stated with clarity and accompanied by supporting data" must not be "subject to perfunctory treatment, but must be given a hard look" by the agency,[22] a court will set aside a waiver determination only if it is arbitrary and capricious or contrary to law.[23] Review under this standard is generally deferential to the agency. A court will determine whether the agency has "articulated a satisfactory explanation for its action, including a rational connection between the facts found and the choice made."[24] The agency's decision must be based on the factors made relevant by Congress and must not constitute a clear error of judgment.[25]

Finally, it may be noted that none of the waivers and variances that were the subjects of the above-discussed cases were issued pursuant to notice and comment rulemaking, and no questions were raised by the courts with respect to the informal processes used to make the determinations. This is hardly surprising since, as the case law makes apparent, waivers and variances are intended as vehicles to provide an element of flexibility and fairness in the regulatory process by authorizing the expeditious agency correction of errors or imposition of unanticipated burdens in individual cases, and not to alter the substantive policy of the agency's governing regulation. As the *Chemical Manufacturers* Court observed:

> An FDF variance does not excuse compliance with a correct requirement, but instead represents an acknowledgment that not all relevant factors were taken sufficiently into account in framing that requirement originally, and that those relevant factors, properly considered, would have justified--indeed required--the creation of a subcategory for the discharger in question. As we have recognized, the FDF variance is a laudable corrective mechanism, " an acknowledgment that the uniform . . . limitation was set without reference to the full range of practices, to which the Administrator was to refer." [citation omitted] *It is, essentially, not an exception to the standard setting process, but rather a more*

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[21] *MacLoed v. ICC, supra* , 54 F.3d at 891; *Florida Cellular Mobil Communication v. FCC*, 28 F.3d 191, 199 (D.C. Cir. 1994), *cert. denied,* 514 U.S. 1016 (1995); *NTN Bearing Corp. v. U.S.*, 74 F.3d 1204, 1207 (Fed. Cir. 1995); *Green County Mobilphone, Inc.* v. *FCC*, 765 F. 2d 275, 238 (D.C.Cir. 1985). *P&R Temmer v. FCC*, 743 F.2d 918, 929 (D.C. Cir. 1984).

[22] *Bellsouth Corporation* v. *FCC*, 162 F. 3d 1215, 1224 (D.C. Cir. 1999); *WAIT Radio* v. *FCC*, 418 F. 2d 1153, 1157 (D.C.Cir. 1969).

[23] 5 U.S.C. 706 (2) (1994).

[24] *Motor Vehicle Mfrs. Ass'n* v. *State Farm Mut. Auto. Ins. Co*, 463 U.S. 29, 43 (1987); *Gilbert* v. *NTSB*, 80 F.3d 364, 368 (9th Cir. 1996).

[25] *Gilbert* v. *NTSB*, *supra*, 80 F.3d at 368.

*fine-tuned application of it.*[26]

We now turn to EPA's waiver options.

Section 211 (k) (2)(B) of the Clean Air Act requires that the oxygen content of gasoline shall equal or exceed 2 percent by weight but that the "Administrator may waive, in whole or part, the application of this subparagraph for any ozone nonattainment area upon a determination by the Administrator that compliance with such requirement would prevent or interfere with the attainment by the area of a national primary ambient air quality standard." The statutory provision would appear to have virtually no utility in the current situation. The Administrator may waive the oxygen content requirement only upon a finding that enforced compliance would in any particular nonattainment area impede attainment in that area "of a national primary ambient air quality standard." Since there appears no dispute that allowing even the temporary use of conventional gasoline will have the deleterious effects sought to be minimized by RFG requirements, it does not appear that the Administrator could validly make such determination. Indeed, just such a contention has been made in opposition to a petition by the State of California under Section 211 (k)(2)(B) requesting a waiver of the federal oxygenates requirement because the oxygenate it is using, methyl tertiary-butyl ether (MTBE), is contaminating water supplies in the State. Opponents contend that California's proferred ground for the waiver is not a contemplated ground for waiver under the statutory provision. The State's petition, which was filed on March 25 1999, has yet to be acted upon.[27] It would seem, then, that the statutory waiver mechanism is arguably neither an apposite nor expeditious vehicle for resolving the instant situation.

Arguably more promising is the EPA's regulatory waiver provision found at 40 CFR 80.73 which permits the issuance of waivers which would allow the distribution of gasoline " for a brief period" which does not meet the requirements for reformulated gasoline in appropriate "extreme and unusual circumstances" that "could not be avoided by the exercise of prudence, diligence and due care." If such extraordinary circumstances are found to obtain, the Administrator then must (1) make a finding that it is in the public interest to waive the requirement; (2) make a finding that the refiner, importer, or oxygenate blender exercised due diligence and still was not able to avoid the nonconformance; (3) the petitioners must show how they will expeditiously achieve the RFG requirements; (4) the petitioners must agree to make up the air quality detriment that has been caused, "where practicable;" and (5) EPA must assure that no windfall accrues to any refiner, importer or oxygenate blender by requiring them to pay into the U.S.

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[26] *Chemical Manufacturers Association* v. *EPA, supra*, 470 U.S. at 130 (emphasis supplied).

[27] CRS Issue Brief, *supra*, at 4-5.

[28] **§80.73 Inability to produce conforming gasoline in extraordinary circumstances.**

In appropriate extreme and unusual circumstances (e.g., natural disaster or Act of God) which are clearly outside the control of the refiner, importer, or oxygenate blender and which could not have been avoided by the exercise of prudence, diligence, and due care, EPA may permit a refiner, importer, or oxygenate blender, for a brief period, to distribute gasoline which does not meet the requirements for reformulated gasoline, if:

(a) It is in the public interest to do so (e.g., distribution of the nonconforming gasoline is necessary to meet projected shortfalls which cannot otherwise be compensated for);

Treasury an amount equal to the economic benefit resulting from the nonconformity minus the amount expended to make up for the air quality detriment.[28]

While the regulatory waiver provision appears to be a more viable vehicle for the present situation, the EPA has until recently followed a third, arguably more problematic course of action. To achieve the effect of a waiver the agency announced in dealing with RFG supply shortages in the St. Louis area that it would " exercise enforcement discretion," *i.e.*, it would not act to impose and enforce nonconformance penalties during a specified period when conventional gasoline would be brought into the area. The conditions imposed by EPA for its prosecutorial forebearance between March 17 and May 5, 2000, as detailed in letters from EPA, did not conform with the requirements of Section 80.73, particularly with regard to the avoidance of windfall profits. Thereafter, until June 19, 2000, windfall profit conditions gradually became more explicit. The chronology is as follows.

On March 17, 2000, the EPA's Assistant Administrator for Enforcement and Compliance, apparently responding to a request from the Missouri Petroleum Marketers and Convenience Store Operators, acknowledged that there was a RFG supply disruption in the St. Louis area caused by a pipeline leak and that the Department of Energy had advised EPA that RFG supplies would be inadequate until early April. In light of the situation, the Enforcement Office announced that effective immediately it would exercise enforcement discretion and would enforce the RFG requirements as follows:

Distributors may receive deliveries of conventional gasoline into terminal tanks normally used to store RFG provided the volume of conventional gasoline is no greater than the volume necessary to supply the terminal's demands through April 3, 2000. Distributors may continue to deliver gasoline from such a tank to facilities in the St. Louis covered area subsequent to April 3 if the tank has received a delivery of RFG.

- Distributors may deliver conventional gasoline to retail outlets and wholesale purchaser-consumer facilities (facilities) in the St. Louis covered area. This category of enforcement discretion expires on April 3, 2000

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(b) The refiner, importer, or oxygenate blender exercised prudent planning and was not able to avoid the violation and has taken all reasonable steps to minimize the extent of the nonconformity;

(c) The refiner, importer, or oxygenate blender can show how the requirements for reformulated gasoline will be expeditiously achieved;

(d)The refiner, importer, or oxygenate blender agrees to make up air quality detriment associated with the nonconforming gasoline, where practicable; and

(e) The refiner, importer, or oxygenate blender pays to the U.S. Treasury an amount equal to the economic benefit of the nonconformity minus the amount expended, pursuant to paragraph (d) of this section, in making up the air quality detriment.

- Distributors may receive deliveries of conventional gasoline into terminal tanks normally used to store RFG provided the volume of conventional gasoline is no greater than the volume necessary to supply the terminal's demands through April 3, 2000. Distributors may continue to deliver gasoline from such a tank to facilities in the St. Louis covered area subsequent to April 3 if the tank has received a delivery of RFG.

- Beginning on April 3, 2000, only RFG may be delivered to terminals that supply facilities in the St. Louis covered area.

- Beginning on May 1, 2000, the gasoline at terminals that supply facilities in the St. Louis covered area must meet all applicable RFG standards including the VOC emissions control standards, and these standards will not be enforced at terminals until this date.

- Beginning on June 1, 2000, the gasoline at retail outlets and wholesale purchaser-consumer facilities in the St. Louis covered area must meet all applicable RFG standards including the VOC emissions control standard, and these standards will not be enforced at these facilities until this date.

The letter makes no reference to Section 80.73 or the conditions and findings that are required by that regulation for approval of a waiver.

On April 3, 2000, the EPA Enforcement Office advised the Missouri Petroleum Marketers that because the anticipated shipments of RFG would not be available as anticipated, the "enforcement discretion relief " under the conditions described in its March 17, 2000 letter would be extended to April 5. On May 5 the continued inadequacy of supplies led EPA to again extend the nonenforcement period to May 8. This time, however, the agency added the following penalty provision: "Each distributor supplying conventional gasoline to the St. Louis covered area under the terms of this enforcement discretion is subject to a penalty of $0.15 per gallon for every gallon of conventional gasoline distributed to the RFG area during the period of this enforcement discretion." EPA also imposed two additional conditions:

> 1) A distributor who has RFG supplies must supply RFG instead of conventional gasoline, and if RFG is made available to other distributors these other distributors must use reasonable efforts to distribute RFG instead of conventional gasoline. However, a distributor supplying gasoline to a retail outlet that has been selling RFG containing MTBE is not required to supply RFG containing ethanol to such retail outlet; and
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> 2) Any distributor who distributes conventional gasoline in the St. Louis covered area under this enforcement discretion explicitly agrees to be subject to the penalty provision above, and agrees to provide EPA

> sufficient information to determine the appropriate penalty amount. Any party who does not comply with these conditions will be liable for violating Section 211 of the Clean Air Act and the RFG regulations at 40 CFR Part 80.

The reference to 40 CFR Part 80 is the first, albeit oblique, mention of the waiver provision.

On May 18, 2000 EPA again acknowledged that shortages would continue until mid-June. As a consequence EPA encouraged use of conventional gasoline but advised that if the shortages continued after June 5, "EPA intends to condition [continued] relief on the payment of penalties that are sufficiently large to create a *significant disincentive to distribute conventional gasoline* instead of RFG." (emphasis in original). EPA also announced that if the shortage continued beyond June 5, all parties distributing conventional gasoline after that date had to sign a Compliance Agreement in which they agreed to " pay to the U.S. Treasury penalties that will be specified at the time the regulatory relief is granted. The size of those penalties will be sufficiently large to at least reflect the benefit gained by substituting conventional gasoline for RFG." EPA again reverted to the exercise of enforcement discretion as the basis of its authority, but made no direct reference to Section 80.73. The nonenforcement period ended on June 19, 2000.

In May 2000, the EPA received requests from the Petroleum Marketers Association of Wisconsin to provide "enforcement discretion" for the requirement to use RFG in the Milwaukee metropolitan area because of the steep increases in the retail cost of RFG. Exercise of enforcement discretion was denied on May 26, 2000 on the ground that there were adequate supplies in the area and that the anticipated shutdown of a pipeline supplying the area would not cause a shortage. EPA also approvingly referenced a communication from the American Petroleum Institute which stated that "issuance of petroleum waivers injects uncertainty into the market and could lead to higher gasoline prices," as well as assurances from distributors that adequate supplies of RFG would be available in the area. EPA noted the health benefits that accrue as a result of the use of RFG and then distinguished its exercise of prosecutorial discretion in St. Louis as follows:

> Given these compelling health benefits from RFG, it is EPA's position that the RFG requirements should be waived only in an extraordinary situation. The RFG regulations provide that relief may be appropriate in extreme and unusual circumstances, such as a natural disaster or an Act of God which clearly is outside the control of the regulated party. For example, the recent regulatory relief granted in St. Louis, described below, was the result of a catastrophic, unexpected situation that could not have been avoided by the exercise of prudence, diligence and due care.
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> On May 18, 2000, EPA granted regulatory relief for the St. Louis metropolitan area allowing use of

> conventional gasoline through June 5. The RFG supply situation in St. Louis, however, was significantly different than in Milwaukee. The supply problem in St. Louis resulted when the Explorer Pipeline experienced a break on March 10, 2000, that forced it to shut down completely for five days and to operate at less than full capacity until September or October of this year. Most of the gasoline used in St. Louis is transported by the Explorer Pipeline. As a result of this unexpected, ongoing supply interruption, most terminals supplying gasoline to St. Louis were out of RFG altogether when relief had not been granted retail stations there would have had no gasoline. The relief will allow RFG supplies to build, so that sufficient RFG will be available to supply the St. Louis market for the remainder of the summer high ozone season.

Thus, retrospectively EPA appears to be describing a situation that would have triggered Section 80.73. However, their actual communications and actions in the matter at the time seemed to ignore the specific findings that had to be made and the conditions that had to be imposed in order to grant an 80.73 waiver. For example, EPA did not impose a windfall profits recovery requirement until very late in the process.

EPA's initial use of "enforcement discretion," or prosecutorial discretion as it is more commonly known, without regard to Section 80.73's specific requirements, may have been legally problematic. EPA may have believed that its action conformed with the Supreme Court's ruling in *Heckler* v. *Chaney*,[29] where the Court held that the decision to initiate or not initiate a proceeding was within the unreviewable discretion of the agency. That case involved the refusal by the Food and Drug Administration (FDA) to review drugs used to carry out the death penalty as "safe and effective" for human executions. The Court found that FDA possessed the kind of broad discretion under the Administrative Procedure Act that is unreviewable because there is "no law to apply." The Court noted the traditional reluctance of courts not to second guess agency decisions not to enforce given an agency's expertise, and better understanding of its enforcement policies and available resources.[30] It also stated that "[t]his Court has recognized on several occasions over many years that an agency's decision not to prosecute or enforce, whether through civil or criminal process is a decision generally committed to an agency's absolute discretion."[31] This was also reflective of the Court's further recognition "that an agency's refusal to institute proceedings shares to some extent the characteristics of the decision of a prosecutor in the Executive Branch not to indict -- a decision that has long been regarded as the special province of the Executive Branch, inasmuch as it is the Executive who is charged by the Constitution to "take care that the laws be faithfully executed."[32]

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[29] 470 U.S. 714 (1985).
[30] 470 U.S. at 831-32.
[31] *Id.* at 831.
[32] *Id.* at 832.

But the Court also emphasized, however, that the presumption of unreviewability of inaction is rebuttable.[33] In that case the Court recognized that Congress can delineate and otherwise circumscribe an agency's discretion. Subsequent case law interpreting and applying *Chaney* have found that agency rules implementing statutory directives may create one or more mandatory, justiciable standards. See, *e.g.*, *McAlpine* v. *United States*, 112 F. 3d 1429 (10th Cir. 1997) (Department of Interior decision declining to acquire land in trust for Indians held subject to judicial review in light of an agency rule that the agency "shall" consider seven factors in making such a decision which thereby provided " law to apply."); *Greater Los Angeles Council on Deafness* v. *Baldridge*, 827 F. 2d 1353 (9th Cir. 1987) (an agency's rule obligating itself to investigate every complaint alleging violation of a statute and to inform complainant of its reason for declining an enforcement action in response to a complaint held to provide "law to apply."). Such rulings are reflective of the long established doctrine that agencies are bound to obey their own legislative rules. See, *e.g., Accardi* v. *Shaughnessy*, 347 U.S. 260 (1954); *Service v. Dulles*, 354 U.S. 363 (1957); *Mine Reclamation Corp. v. FERC*, 30 F.3d 1519, 1524 (D.C. Cir. 1994).

40 CFR 80.73 is arguably such a binding rule and the failure of EPA to follow its terms during the first several months of the St. Louis situation would likely be held to be subject to judicial review although we would not speculate on the outcome of such a challenge. Arguably, however, the continued utilization of "enforcement discretion" by EPA rather than applying the prescriptions of Section 80.73 casts doubt as to the legal substantiality of both grants and denials of waivers (or their equivalents). Thus while the factual distinctions made by EPA between the St. Louis and Milwaukee situations may be both sound and persuasive, the uncertainty of the legal basis for those decisions leaves a cloud of doubt for future similar situations.

In summary, then, it would appear that Section 80.73 is, in the words of *Heckler*, the "law to apply" and that the use of prosecutorial discretion may be legally problematic. Thus, the regulation would appear to be the sole viable vehicle by which EPA might provide waiver relief for situations like St. Louis or Chicago/Milwaukee.

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[33] *Id.* at 833.